Report

of the

Examination of

Sheboygan Falls Mutual Insurance Company

Sheboygan Falls, Wisconsin

As of December 31, 2000

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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November 2, 2001

Honorable Connie L. O'Connell
Commissioner of Insurance
State of Wisconsin
121 East Wilson Street
Madison, WI 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

SHEBOYGAN FALLS MUTUAL INSURANCE COMPANY
Sheboygan Falls, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of the company was conducted in 1996 as of December 31, 1995. The current examination covered the intervening period ending December 31, 2000, and included a review of such 2001 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employees' Welfare and Pension Plans

Territory and Plan of Operations
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

An independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code, annually audits the company. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

II. HISTORY AND PLAN OF OPERATION

The company was organized in May, 1899, as The Village of Sheboygan Falls Mutual Fire Insurance Company, and commenced business on August 18, 1899. In January, 1934, the present name of the company was adopted. The Manitowoc Mutual Fire Insurance Company and the Mutual Fire Insurance Company were merged into the company on July 1, 1962 and November 1, 1966, respectively. Also, the business of German Mutual Fire Insurance Company was reinsured as of November 1, 1964.

Sheboygan Falls Mutual Insurance Company is a mutual fire and casualty insurer, which writes business only in Wisconsin. The company operates on a mutual plan, issuing nonassessable policies, with business being acquired through independent agents.

The major products marketed by the company include homeowner's, auto physical damage, private passenger auto liability, and commercial multiple peril. It also writes worker's compensation. The company's certificate of authority was amended to include auto as of May 1990. The products are marketed through 655 independent agents in around 150 agencies.

The following table is a summary of the net insurance premiums written by the company in 2000. The company does not assume any business. The growth of the company is discussed in the Financial Data section of this report.

Line of Business	Direct Premium	Reinsurance Ceded	Net Premium
Fire	$ 177,460	$ 77,653	$ 99,807
Allied lines	75,193	17,486	57,707
Homeowner's multiple peril	2,524,743	1,080,980	1,443,763
Commercial multiple peril	912,322	371,612	540,710
Inland marine	296,902	149,433	147,469
Worker's compensation	132,433	34,789	97,644
Other liability - occurrence	161,316	79,414	81,902
Private passenger auto liability	1,165,344	540,541	624,803
Auto physical damage	1,377,968	599,765	778,203
Total All Lines	$6,823,681	$2,951,673	$3,872,008

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of nine members. Three directors are elected annually to serve a three-year term. Officers are elected at the board's annual meeting. The board members currently receive an annual salary of $2,500 plus $200 for every board meeting attended. In addition, committee members receive $75 per meeting attended.

Board member Donald E. Koehn, lifetime executive director, receives an annual salary of $5,000 in place of fees for meetings attended. Donald Koehn was given the title "lifetime executive director" as of January 1, 1990 through a resolution passed by the board. He is a former president of the company and chairman of the board. In addition, he must be reelected every three years to serve as a director.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Joseph E. Schintgen Sheboygan Falls, WI	Retired Paint Salesman	2002
Merlin A. Moths Sheboygan Falls, WI	Retired Accountant	2002
Kenneth F. Maurer Sheboygan Falls, WI	Retired Banker	2002
Gerald J. Ziegler Sheboygan Falls, WI	Retired Life Insurance Agent	2003
Gene H. Specht Sheboygan Falls, WI	Electrical Contractor	2003
Tom A. Heidenreiter Sheboygan Falls, WI	Bus Company Owner	2003
Lee F. Wilcox Sheboygan, WI	President, Sheboygan Falls Mutual	2004
Donald E. Koehn Sheboygan Falls, WI	Retired Attorney	2004
Thomas A. Scribner Sheboygan Falls, WI	Retired Auto Dealer	2004

Officers of the Company

The officers serving at the time of this examination are as follows:

Name	Office	2000 Compensation
Lee F. Wilcox	President/Treasurer	$164,032
Kenneth F. Maurer	Secretary	0
Janice L. Tupper	Vice President	54,566
Bradford C. Bailey	Asst. Vice President	54,323

Committees of the Board

The president appoints the committees of the board of directors. The company's bylaws do not provide for the formation of committees of the board. The committees at the time of the examination are listed below:

Executive Committee
Lee F. Wilcox, Chair
Kenneth F. Maurer
Bradford C. Bailey
Janice L. Tupper

Long Range Planning Committee
Thomas A. Scribner, Chair
Merlin A. Moths
Donald E. Koehn
Lee F. Wilcox

Investment Committee
Gene H. Specht, Chair
Thomas A. Scribner
Tom A. Heidenreiter
Donald E. Koehn
Lee F. Wilcox

Audit Committee
Gerald J. Ziegler, Chair
Joseph E. Schintgen
Kenneth F. Maurer
Donald E. Koehn

Personnel & Salary Committee
Merlin A. Moths, Chair
Kenneth F. Maurer
Donald E. Koehn
Lee F. Wilcox

IV. REINSURANCE

The company's reinsurance treaties in force at the time of the examination are summarized below. The contracts contained proper insolvency provisions.

Nonaffiliated Ceding Contracts

1. Type: Property Surplus

Reinsurer: Through Intermediary – Towers Perrin Reinsurance

Participating reinsurers:

Participating reinsurers	1st	2nd
St. Paul Fire & Marine	20.0%	20.0%
The TOA Reinsurance Co. of America	20.0	20.0
Mutual Reinsurance Bureau*	60.0	60.0
	100.0%	100.0%

1st = First Property Surplus
2nd = Second Property Surplus

Scope: All property business written by the company

Retention: First Surplus – $60,000 as respects the Coverage A of Homeowner’s, Mobile Homeowner’s and Dwelling Fire policies

Second Surplus – $220,000 as respects the Coverage A of Homeowner’s, Mobile Homeowner’s, and Dwelling Fire policies

First Surplus – $120,000 Commercial policies

Second Surplus – $400,000 Commercial policies

Coverage: First Surplus – $160,000 excess of $60,000 as respects Coverage A of Homeowner’s, Mobile Homeowner’s, and Dwelling Fire policies

Second Surplus – $335,000 excess of $220,000 as respects Coverage A Homeowner’s, Mobile Homeowner’s, and Dwelling Fire policies

First Surplus – $280,000 excess of $120,000 Commercial policies

Second Surplus – $600,000 excess of $400,000 Commercial policies

Second Surplus – Cessions above maximum limits, of $1,500,000 per risk for total of 12 risks each calendar year

Premium: Pro rata of subject premium

Commissions: First Surplus – 27.5% provisional commission. Commission adjustment increases for loss ratios less than 50.0%, with no adjustment decreases for loss ratios of 65% or higher

Second Surplus – 27.5% of net premium ceded

Effective date: January 1, 2001

Termination: By either party giving 60 days' notice in writing by certified mail to the other party effective the first day of any calendar year

2. Type: First Property Per Risk Excess

Reinsurer: Through Intermediary – Towers Perrin Reinsurance
Participating reinsurers:

Farm Family Casualty Ins. Co.	15.0%
St. Paul Fire & Marine	20.0
Mutual Reinsurance Bureau *	65.0
	100.0%

Scope: All property business written by the company

Retention: $35,000 on each and every loss and risk

Coverage: $85,000 excess of $35,000 not more than $255,000 each and every loss occurrence

Premium: 11.75% of its net subject earned premium

Contingent Commission: 50% of the net profit for each loss year. It is based on the premiums earned, less expenses incurred at 20% of premiums and losses incurred in the loss year with adjustments to each accident year as all outstanding losses are settled.

Effective date: January 1, 2001

Termination: By either party giving 60 days' notice in writing by certified mail to the other party effective the first day of any calendar year

3. Type: Liability Excess

Reinsurer: Through Intermediary – Towers Perrin Reinsurance
Participating reinsurers:

	1st	2nd	3rd
Employers Mutual Casualty Company	0.0%	20.0%	0.0%
Hanover Ruckversicherung AG	0.0	40.0	30.0
SCOR Reinsurance Company	20.0	0.0	20.0
St. Paul Fire and Marine Ins. Co.	20.0	0.0	0.0
Mutual Reinsurance Bureau *	60.0	40.0	50.0
	100.0%	100.0%	100.0%

1st = First Liability Excess
2nd = Second Liability Excess
3rd = Third Liability Excess

Scope: Liability business of Homeowner's, Mobile Homeowner's, Businessowners, Special M.P., Commercial Package Policies, Worker's Compensation, and General Liability

	Retention:	First Liability Excess – $33,000 each and every loss occurrence Second Liability Excess – $100,000 each and every loss occurrence Third Liability Excess – $500,000 each and every loss occurrence
	Coverage:	First Liability Excess – $67,000 excess of $33,000 of each and every loss occurrence Second Liability Excess – $400,000 excess of $100,000 of each and every loss occurrence Third Liability Excess – $1,500,000 excess of $500,000 of each and every loss occurrence
	Premium:	First Liability Excess – 10.50% of its net subject earned premium Second Liability Excess – 8.0% of its net subject earned premium Third Liability Excess – 3.0% of its net subject earned premium
	Contingent Commission:	First Liability: 25% of the net profit accruing to the reinsurers during each accounting period, only for the first layer.
	Effective date:	January 1, 2001
	Termination:	By either party giving 60 days' notice in writing by certified mail to the other party effective the first day of any calendar year
4.	Type:	Automobile Quota Share
	Reinsurer:	Through Intermediary – Towers Perrin Reinsurance Participating reinsurers:

Mutual Reinsurance Bureau *	50.0%
SCOR Reinsurance Company	40.0
St. Paul Fire and Marine Ins. Co.	10.0
	100.0%

	Scope:	All Private Passenger Automobile Liability and Physical Damage business of the company
	Retention:	70% quota share of the net retained liability on any one policy, any one loss occurrence Maximum policy limits for any one insured: $500,000 per person/$500,000 per occurrence - Bodily Injury $500,000 per person/$500,000 per occurrence - Uninsured/ Underinsured Motorist $100,000 per occurrence - Property Damage $10,000 per occurrence - Medical Payments $60,000 per vehicle - Automobile Physical Damage

Coverage:	30% quota share of the net retained liability on any one policy, any one loss occurrence
Premium:	30% of the net subject written premium on all policies
Commission:	30% on all premiums ceded
Contingent commission:	50% on the net profit of each 12-month accounting period.
Effective date:	January 1, 2001
Termination:	By either party giving 60 days' notice in writing by certified mail to the other party effective the first day of any calendar year.

5. Type: Automobile Excess

Reinsurer: Through Intermediary – Towers Perrin Reinsurance
Participating reinsurers:

St. Paul Fire and Marine Ins. Co.	30.0%
SCOR Reinsurance Company	45.0
Mutual Reinsurance Bureau *	25.0
	100.0%

Scope:	All Private Passenger Automobile Liability and Physical Damage (collision only) business of the company
Retention:	$50,000 each loss occurrence

Maximum policy limits for any one insured:
$500,000 per person/$500,000 per occurrence - Bodily Injury
$500,000 per person/$500,000 per occurrence -Uninsured/ Underinsured Motorist
$100,000 per occurrence - Property Damage
$10,000 per occurrence - Medical Payments
$60,000 per vehicle - Automobile Physical Damage

Coverage:	$1,950,000 excess of $50,000 each loss occurrence
Premium:	18.50% of its net subject earned premium
Commission:	30% of net premium ceded
Effective date:	January 1, 2001
Termination:	By either party giving 60 days' notice in writing by certified mail to the other party effective the first day of any calendar year

6. Type: Umbrella Quota Share

Reinsurer: Through Intermediary – Towers Perrin Reinsurance

Participating reinsurers:

SCOR Reinsurance Company	35.0%

	Mutual Reinsurance Bureau *	65.0
		100.0%

Scope: All company business classified as Personal and Commercial Umbrella Liability

Retention: 3% of each of the company's losses up to $1,000,000 or less for the business insured

Coverage: 97% quota share participation of the company's net liability on any one risk, any one occurrence up to $1,000,000

100% of the second $1,000,000 of the company's losses for the business insured
Personal Umbrella policies are subject to minimum underlying limits

Premium: 70.325% of the net subject written premium of the company for the first $1,000,000 of policy limits and 72.5% of the gross written premium of the company for the second $1,000,000

Effective date: January 1, 2001

Termination: By either party giving 60 days' notice in writing to the other party effective the first day of any calendar year

7. Type: Excess Catastrophe

Reinsurer: Through Intermediary – Towers Perrin Reinsurance
Participating reinsurers:

	1st	2nd
SOREMA North America Reinsurance Co.	30.0%	10.0%
The Underwriters at Lloyd's, #2010	12.5	10.0
Odyssey America Reinsurance Corp.	50.0	0.0
The TOA Reinsurance Co. of America	0.0	15.0
Mutual Reinsurance Bureau *	7.5	65.0
	100.0%	100.0%

Scope: All property business written by the company

Retention: First Excess – Up to $150,000 each loss occurrence plus 5% of the excess between $150,000 and $500,000 (up to $17,500)

Second Excess – $500,000 each loss occurrence

Coverage: First Excess – 95% of the excess net loss between $150,000 and $500,000 up to maximum of $332,500 (95% of $350,000) for each and every loss occurrence

Second Excess – 100% of the excess between $500,000 and $2,000,000 up to maximum $1,500,000 for each and every loss occurrence

	Premium:	First Excess – 3.53% of the subject net earned premium income of the company, with a deposit premium of $60,000, subject to a minimum premium of $48,000 Second Excess – 3.09% of the subject net earned premium, with a deposit premium of $52,000, subject to a minimum premium of $42,000
	Effective date:	January 1, 2001
	Termination:	January 1, 2002
8.	Type:	Third Excess Catastrophe
	Reinsurer:	Through, Intermediary – Towers Perrin Reinsurance Participating reinsurer: SCOR Reinsurance Company 100.0%
	Scope:	All property business written by the company
	Retention:	$2,000,000 each and every loss occurrence
	Coverage:	100% of the excess net loss between $2,000,000 and $10,000,000 up to a maximum $8,000,000 for each and every loss occurrence
	Premium:	Flat premium of $100,000 in 4 equal installments of $25,000. If Annual Statement Loss & ALAE ratio is less than 60.0% and greater than 57%, premium shall be increased to $125,000. If Annual Statement Loss & ALAE ratio is less than 57%, premium shall be increased to $150,000.
	Effective Date:	January 1, 2001
	Termination:	January 1, 2002
9.	Type:	Workers' Compensation Excess
	Reinsurer:	Through Intermediary – Towers Perrin Reinsurance Participating reinsurer: Reliastar Life Insurance Company 100.0%
	Scope:	All workers' compensation business written by the company
	Retention:	$2,000,000 each and every loss occurrence, and all losses above $5,000,000 for each and every loss occurrence
	Coverage:	$3,000,000 excess of $2,000,000 any one loss occurrence
	Premium:	$7,500 annual premium in equal installments of $1,875.
	Effective date:	January 1, 2001
	Termination:	January 1, 2002

* Mutual Reinsurance Bureau, a major participant in the company's reinsurance program, is an unincorporated association comprised of the following six insurance companies:

Auto-Owners Insurance Company
Employers Mutual Casualty Company
Erie Insurance Exchange
Farmers Mutual Hail Insurance Company of Iowa
Motorists Mutual Insurance Company
Shelter Mutual Insurance Company

Where Mutual Reinsurance Bureau was listed as a reinsurer, the above six companies each assume one-sixth of the risk.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 2000, annual statement to the Commissioner of Insurance. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination is noted at the end of this section in the area captioned “Reclassification per Examination.”

Sheboygan Falls Mutual Insurance Company
Assets
As of December 31, 2000

	Ledger Assets	Nonledger Assets	Nonadmitted Assets	Admitted Assets
Bonds	$5,618,784	$	$	$5,618,784
Stocks:				
Common stocks	418,494	403,680		822,174
Real estate:				
Occupied by the company	186,384			186,384
Other properties	116,843			116,843
Cash	47,448			47,448
Short-term investments	326,019			326,019
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	329,765		171	329,594
Reinsurance recoverable on loss and adjustment payments	51,016			51,016
Federal income tax recoverable and interest thereon	87,331			87,331
Electronic data processing equipment	65,767			65,767
Interest, dividends, and real estate income due and accrued	100,506			100,506
Other assets nonadmitted:				
Equipment, furniture, and supplies	14,456		14,456	0
Write-ins for other than invested assets				
CSV-Life Insurance	263,124			263,124
Total Assets	$ 7,625,937	$403,680	$14,627	$8,014,990

Sheboygan Falls Mutual Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2000

Losses	$1,057,355
Loss adjustment expenses	296,000
Contingent commissions and other similar charges	15,675
Other expenses (excluding taxes, licenses, and fees)	188,231
Taxes, licenses, and fees (excluding federal and foreign income taxes)	2,411
Unearned premiums	1,944,441
Amounts withheld or retained by company for the account of others	18,598
Excess of statutory over statement reserves	170,000
Write-ins for liabilities:	
Advance Premiums	124,493
Total Liabilities	3,817,204
Unassigned funds (surplus)	4,197,786
Surplus as Regards Policyholders	4,197,786
Total Liabilities, Surplus, and Other Funds	$8,014,990

Sheboygan Falls Mutual Insurance Company
Summary of Operations
For the Year 2000

Underwriting Income	
Premiums earned	$3,640,009
Deductions	
Losses incurred	2,380,886
Loss expenses incurred	514,731
Other underwriting expenses incurred	1,453,538
Total underwriting deductions	4,349,155
Net underwriting loss	(709,146)
Investment Income	
Net investment income earned	350,348
Net realized capital losses	(8,012)
Net investment gain	342,336
Other Income	
Net (loss) from agents' or premium balances charged off	(736)
Finance and service charges not included in premiums	42,755
Total other income	42,019
Net income before dividends to policyholders and before federal and foreign income taxes	(324,791)
Dividends to policyholders	3,075
Net income after dividends to policyholders but before federal and foreign income taxes	(327,866)
Federal and foreign income taxes incurred	(51,042)
Net Income Loss	$ (276,824)

Sheboygan Falls Mutual Insurance Company
Cash Flow
As of December 31, 2000

Premiums collected net of reinsurance	$3,875,935		
Loss and loss adjustment expenses paid (net of salvage or subrogation)	2,624,015		
Underwriting expenses paid	1,493,867		
Cash from underwriting		$(241,947)	
Investment income (net of investment expense)		356,044	
Other income (expenses):			
Agents' balances charged off		(736)	
Net amount withheld or retained for account of others		4,913	
Write-ins for miscellaneous items:			
Finance & Service Charges		42,755	
Total other income		46,932	
Deduct:			
Dividends to policyholders paid		3,075	
Federal income taxes paid		67,919	
Net cash from operations			$ 90,035
Proceeds from investments sold, matured, or repaid:			
Bonds		899,998	
Stocks		181,706	
Total investment proceeds			1,081,704
Cost of investments acquired (long-term only):			
Bonds		918,042	
Stocks		76,705	
Real estate		9,579	
Total investments acquired			1,004,326
Net cash from investments			77,378
Cash provided from financing and miscellaneous sources:			
Other cash provided		26,865	
Total			26,865
Cash applied for financing and miscellaneous use			
Other applications		26,852	
Total			26,852
Net cash from financing and miscellaneous sources			13
Net change in cash and short-term investments			167,426
Reconciliation			
Cash and short-term investments, December 31, 1999			206,041
Cash and short-term investments, December 31, 2000			$ 373,467

Sheboygan Falls Mutual Insurance Company
Compulsory and Security Surplus Calculation
December 31, 2000

Assets		$8,014,990	
Less liabilities		3,817,204	
Adjusted surplus			$4,197,786
All insurance	$3,868,933		
Factor	20%		
Total		773,787	
Compulsory surplus*			1,200,000
Compulsory surplus excess			$2,997,786
Adjusted surplus			$4,197,786
Security surplus: (140% of compulsory surplus)			1,680,000
Security surplus excess			$2,517,786

*Pursuant to the company's license the company has a permanent surplus of $1,200,000.

Sheboygan Falls Mutual Insurance Company
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 2000

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	1996	1997	1998	1999	2000
Surplus, beginning of year	$3,429,995	$3,882,748	$4,333,807	$4,268,849	$4,545,462
Net income	271,069	435,270	(243,810)	245,524	(276,824)
Net unrealized capital gains or (losses)	106,714	(5,888)	99,461	(10,678)	(45,643)
Change in nonadmitted assets	6,172	15,683	(1,607)	3,850	4,298
Change in excess of statutory reserves over statement reserves	68,800	6,000	81,000	5,000	32,000
Write-ins for gains and (losses) in surplus:					
Rounding	(2)	(6)	(2)		
Change in Cash Surrender Value				32,917	(61,507)
Surplus, end of year	$3,882,748	$4,333,807	$4,268,849	$4,545,462	$4,197,786

Sheboygan Falls Mutual Insurance Company
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2000

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period under examination. Exceptional ratios are denoted with asterisks. A discussion of the exceptional ratios may be found after the IRIS ratios.

	Ratio	1996	1997	1998	1999	2000
#1	Gross Premium to Surplus	122.0%	116.0%	129.0%	134.0%	163.0%
#1A	Net Premium to Surplus	72.0	66.0	73.0	72.0	92.0
#2	Change in Net Writings	10.0	3.0	9.0	4.0	18.0
#3	Surplus Aid to Surplus	4.0	5.0	4.0	5.0	5.0
#4	Two-Year Overall Operating Ratio	87.0	86.0	99.0	102.0*	100.0*
#5	Investment Yield	4.7	4.5*	4.9	4.62	4.9
#6	Change in Surplus	12.0	9.0	0.0	6.0	-6.0
#7	Liabilities to Liquid Assets	50.0	48.0	53.0	50.0	57.0
#8	Agents' Balances to Surplus	11.0	10.0	11.0	11.0	13.0
#9	One-Year Reserve Development to Surplus	-7.0	-2.0	-4.0	-1.0	-3.0
#10	Two-Year Reserve Development to Surplus	-2.0	-10.0	-4.0	-2.0	-3.0
#11	Estimated Current Reserve Def. To Surplus	-6.0	0.0	-7.0	-1.0	-5.0

Ratio No. 4 measures the company's profitability over the previous two-year period. The exceptional results in 1999 and 2000 were due to some unusually severe storms resulting in numerous claims. The company experienced four catastrophe losses during 1998, and the single largest loss ever experienced by the company occurred on May 12, 2000.

Ratio No. 5 measures the company's investment yield. The exceptional result calculated by the NAIC for 1997 was 4.5%, the same as the NAIC's minimum investment yield for that year. The company emphasized that the yield was actually 4.54%, and should not have been identified as an unusual result by the NAIC. The value for 1997 resulted, in part, from the allocation to investment expenses of a high percentage of the company's total expenses incurred. The percentage was 5.95% in 1995, 5.5% in 1996 and 5% in 1997, compared to 2.9% in 1998 and 2.7% in 1999. The lower allocation in 1998 and 1999 relates to a suggestion in the prior examination report regarding the allocation of investment expenses.

Growth of Sheboygan Falls Mutual Insurance Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
1996	$7,053,339	$3,170,591	$3,882,748	$271,069
1997	7,334,771	3,000,964	4,333,807	435,270
1998	7,584,683	3,315,834	4,268,849	(243,810)
1999	7,933,304	3,387,842	4,545,462	245,524
2000	8,014,990	3,817,204	4,197,786	(276,824)
9-30-2001	7,862,296	4,157,136	3,705,160	(491,548)

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
1996	$4,732,146	$2,794,108	$2,707,663	54.2%	40.9%	95.1%
1997	5,026,981	2,867,245	2,903,730	58.5	37.6	96.1
1998	5,526,508	3,134,388	2,984,715	80.7	41.2	121.9
1999	6,112,118	3,271,618	3,226,216	63.6	39.1	102.7
2000	6,823,681	3,872,008	3,640,010	79.5	36.5	116.0
*9-30-2001	5,386,384	3,170,583	3,066,003	89.1	35.1	124.2

*Figures are as of September 30 and are not annualized.

For the years 1998, 2000, and 2001 the company's results were affected by a number of storms. In 2000 and 2001, the company has increased premium rates, reduced commissions, and made underwriting changes. In 2002 further rate increases are planned. Since 1995 gross premiums written have increased by 65.9% or $2.7 million. $2 million of the increase in premium is from private passenger auto liability and physical damage. Surplus as of September 30, 2001 is the lowest since year-end 1995. In the reinsurance plan for 2000 and 2001, the company has retained more of the auto risk, and the net effect of any single loss for 2001 is $35,000 or less.

Reclassification per Examination

Examination Reclassification

	Debit	Credit
Cash		$246,322
Short-term investments	$246,322	
Total reclassifications	$246,322	$246,322

The examination resulted in no adjustments to “Surplus as Regards Policyholders.”

VI. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were three specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Management and Control—It is recommended that the company answer correctly all general interrogatories pursuant to the NAIC Annual Statement Instructions-Property and Casualty companies.

   Action—Compliance.

2. Bonds—It is recommended that the company report the correct CUSIP number in its Schedule D and submit a Security Acquisition Request (SAR) for securities which do not appear in the NAIC VOS manual in accordance with the NAIC Annual Statement Instructions-Property and Casualty companies.

   Action—Compliance.

3. Investments—It is suggested that the company review its allocation of investment expenses in order to report a more reasonable expense incurred allocation in the annual statement's "Underwriting and Investment Exhibit, Part 4 - Expenses."

   Action—Compliance.

Summary of Current Examination Results

Corporate Records

Review of minutes of the board of directors noted that some items discussed did not have a motion for approval. This includes approval of investment transactions. Items were discussed in the minutes and often approved by a committee of the board. However, there was not always approval by the board of committee minutes. Prior to 2001 the investment committee meetings did not always have a majority in attendance when action was taken. It is recommended that the minutes for the board of directors indicate with a motion, action taken by the board of directors and approval of actions taken by committees of the board.

Bylaw Section XVII states that no member of the Board "may be elected or re-elected, to an office on the Board or in the company if he has reached his 65th birthday on the date of the election…."If federal or state law prohibits such practice, this selection shall automatically be amended to conform to any such federal or state law". It is recommended that the company obtain an independent review of Bylaw Section XVII from an outside law firm, and based on the advice received the board should either amend or delete the bylaw or comply with it. If this bylaw were followed it would affect 6 of the 9 directors.

Accounts and Records

The company does not receive individual broker advices for investment purchases and sales from their investment broker/custodian, as the investment transactions are executed by the broker in large lots. In 2001 the company began to receive a memo from the custodian that a transaction had been completed. Also, the company does not have a reporting system for maintaining investment transaction history, except for the monthly custodial statements. It is suggested that the company maintain an investment ledger or similar records that includes information for each investment to document the company's ownership and valuation of investments. It should provide a history of purchases, sales, splits, etc. by security.

The company does not have a minimum dollar amount for capitalizing real estate amounts. Also, there were some capitalized items that should have been expensed, such as $10,300 for office panels. Only expenditures that add to or prolong the life of the property should be capitalized, per the NAIC Accounting Practices and Procedures Manual. It is recommended that the company only capitalize real estate items per the NAIC Accounting Practices and Procedures Manual, and that the company consider establishing a minimum dollar limit for expensing small real estate items.

Bonds

Schedule D and the company's investment records were not in compliance with the new Provisionally Exempt rating requirements of the NAIC Securities Valuation Office. Provisionally exempt securities with a rating of 1 or 2 are be reported as "1PE" or "2PE" on Schedule D - Part 1.

Also, the company is required to keep documentation of up to two rating services to support the equivalent of a "1PE" or "2PE" rating for each of the securities. If the investment does not meet the conditions or the company does not have the documentation for the security, it is required to make a proper security filing with the SVO. It is recommended that the company be in compliance with the Provisionally Exempt rating requirements of the NAIC Securities Valuation Office.

Cash in Company's Office

The reported amount of this account consists of petty cash. Money held by the company is secured in the company's vault. It was noted that money collected and not deposited in the bank was held at the company, but was not recorded on the annual statement. This was usually for new business premium, paid by the policyholder at the company's offices. It is recommended that money held at the company be shown on the annual statement as 'Cash in the Company's Office' in Schedule E- Part 1 and as 'Remittances and Items Not Allocated' in accordance with the NAIC Annual Statement Instructions.

Short-term Investments

The company's bank currently invests overnight amounts above a set minimum for its General checking account under a Repurchase agreement with its custodian. The money is withdrawn from the checking account, invested overnight, and then redeposited into the checking account the next business day. The company accounts for the withdrawal of the funds from the General account as a reconciling item on the bank reconciliation. The company included the overnight repurchase at year-end as cash, rather than as a short-term investment. According to the NAIC Accounting Practices and Procedures Manual, SSAP 2 paragraph 10, repurchase agreements should be reported as short-term investments, not as cash. The overnight investment at year-end was $246,322. This amount is reflected in the "Reclassification per Examination" as a reclassification from cash to short-term investments. It is recommended that securities invested in overnight funds be shown on Schedule DA of the annual and quarterly statements.

Agents Balances or Uncollected Premium

The company reported all agents' balances and uncollected premium on line 10.1 of the annual statement. Testing of the direct bill receivable detail records indicated that balances often were for deferred payments that will be due on installments, which should be reported on line 10.2. The company records premium when a payment is received, except that advance premium is recorded on the effective date. The agents balances and uncollected premium receivable amount was also overstated as it included installment premiums remaining on advance premiums. (See also the comments on the Advance Premium liability.) It is recommended that:

- direct bill and installment amounts that are booked but deferred and not yet due be reported on line 10.2 for Assets per the NAIC Annual Statement Instructions; and that
- direct bill receivables do not include installments due on advance premium receipts.

Any policy premium paid prior to the effective date of a policy is not booked until the actual effective date of the policy. Renewal premiums that are paid in the grace period are the only premiums not booked on the effective date. The NAIC Accounting Practices and Procedures Manual, SSAP 53, paragraph 5, states that written premiums shall be recorded on the effective date of the contract. This accounting rule applied to the company beginning January 1, 2001.

Under the company's procedures, a policy with a renewal date in December may be paid in January (under the limits of the company's grace period). The company's current computer system cannot hold open December renewal records to include payments made during the January grace period, so there is no practical way to enter them as December transactions on the effective date on the policy. This results in the company's December financial statements not reporting the unearned premium, any deferred installments receivable, the agent commission expense, reinsurance premium ceded, and premium tax expense for those policies; they are reported with January business. At the present time, management and its external auditor believe these differences are immaterial to the company's overall financial position. The company is advised that it should continually monitor the difference between SSAP 53 and its current accounting practices; if the difference becomes material the company should develop a procedure to report on the effective date, or seek a permitted accounting practice from this office. When the company considers upgrading its software, it should review the new software's ability to comply with SSAP 53.

The agency installment receivable had a difference of approximately $7,000 between the general ledger and the subsidiary records. For the related agency installment commissions payable, the company was unable to provide a detail trial balance supporting the account. Also, there was no agent subsidiary ledger by agent/agency that provided beginning and ending balances and the payments made. The company plans to phase out agent billings in 2002.

Unearned Premiums

The company was unable to provide detail inforce and unearned records by policy, which would document and support unearned premium. Also, the unearned ceded reports did not show the inforce. It is recommended that the company comply with s. Ins 6.80, Wis. Adm. Code, for the retention of records by maintaining records or the ability to reproduce detail inforce and unearned records to document and support the direct and ceded unearned premium in the company's annual statement.

Amounts Withheld or Retained by Company for Account of Others

Included in the annual statement balance of $18,598 was $14,074 for unmatched new business deposits. The unmatched funds are for new policies that have not yet been issued, and set up on the policyholder system. The company was not able to provide a detailed listing of the year-end balance. The company tried to reconstruct the account balance, but had an unexplainable difference of $800 that went back more than a month. It appears the company has monthly listings but they are not kept. It is recommended that the company:

- report unmatched new business deposits as 'Remittances and Items Not Allocated' on the annual and quarterly statements;
- reconcile the monthly-unmatched new business report to the general ledger; and
- monitor the unmatched business report for aged items not clearing on a timely basis.

This annual statement line also includes a liability for escheatable funds. A review of outstanding checks in the checking accounts noted 40 checks totaling $14,854 from 1997-1999. It is suggested that the company periodically review outstanding checks and transfer old uncashed checks to the 'Amounts Withheld or Retained for Account of Others' liability.

Advance Premiums

The company maintains a report of advance premiums received; however it includes the full annual premium, not the portion actually paid in advance. The liability for advance premiums, and the asset for premiums receivable, were both overstated by about $20,000. It is recommended that the company include only the actual cash received as advance premium, that the record of advance premiums be reconciled at least quarterly, and that unreconcilable balances that cannot be cleared be written off.

VII. CONCLUSION

For 1998, 2000 and 2001 the company's results were affected by a number of severe storms. The company had net losses of ($243,810) in 1998, ($276,824) in 2000, and ($491,548) as of 9-30-2001. Surplus as of year-end 2000 was $4,197,786 and was $3,705,160 as of September 30, 2001, the lowest since 1995. The company in 2000 and 2001 has increased premium rates, reduced commissions, and made underwriting changes. In 2002 further rate increases are planned, along with phasing out of billings to agents.

VIII. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 23 — **Corporate Records**—It is recommended that the minutes for the board of directors indicate with a motion, action taken by the board of directors and approval of actions taken by committees of the board.

2. Page 23 — **Corporate Records**—It is recommended that the company obtain an independent review of Bylaw Section XVII from an outside law firm, and based on the advice received the board should either amend or delete the bylaw or comply with it.

3. Page 23 — **Accounts and Records**—It is suggested that the company maintain an investment ledger or similar records that includes information for each investment to document the company's ownership and valuation of investments.

4. Page 24 — **Accounts and Records**—It is recommended that the company only capitalize real estate items per the NAIC Accounting Practices and Procedures Manual, and that the company consider establishing a minimum dollar limit for expensing small real estate items.

5. Page 24 — **Bonds**—It is recommended that the company be incompliance with the Provisionally Exempt rating requirements of the NAIC Securities Valuation Office.

6. Page 25 — **Cash in Company's Office**—It is recommended that money held at the company be shown on the annual statement as 'Cash in the Company's Office' in Schedule E- Part 1 and as 'Remittances and Items Not Allocated' in accordance with the NAIC Annual Statement Instructions.

7. Page 25 — **Short-term Investments**—It is recommended that securities invested in overnight funds be shown on Schedule DA of the annual and quarterly statements.

8. Page 26 — **Agents' Balances or Uncollected Premium**—It is recommended that direct bill and installment amounts that are booked but deferred and not yet due be reported on line 10.2 for Assets per the NAIC Annual Statement Instructions; and that direct bill receivables do not include installments due on advance premium receipts.

9. Page 26 — **Agents' Balances or Uncollected Premium**—The company is advised that it should continually monitor the difference between SSAP 53 and its current accounting practices; if the difference becomes material the company should develop a procedure to report on the effective date, or seek a permitted accounting practice from this office. When the company considers upgrading its software, it should review the new software's ability to comply with SSAP 53.

10. Page 26 — **Unearned Premiums**—It is recommended that the company comply with s. Ins 6.80, Wis. Adm. Code, for the retention of records by maintaining records or the ability to reproduce detail inforce and unearned records to document and support the direct and ceded unearned premium in the company's annual statement.

11. Page 27 **<u>Amounts Withheld or Retained by Company for Account of Others</u>**—It is recommended that the company report unmatched new business deposits as 'Remittances and Items Not Allocated' on the annual and quarterly statements, reconcile the monthly-unmatched new business report to the general ledger, and monitor the unmatched business report for aged items not clearing on a timely basis.

12. Page 27 **<u>Amounts Withheld or Retained by Company for Account of Others</u>**—It is suggested that the company periodically review outstanding checks and transfer old uncashed checks to the 'Amounts Withheld or Retained for Account of Others' liability.

13. Page 27 **<u>Advance Premiums</u>**—It is recommended that the company include only the actual cash received as advance premium, that the record of advance premiums be reconciled at least quarterly, and that unreconcilable balances that cannot be cleared be written off.

IX. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
Thomas Janke	Financial Examiner
Jerry DeArmond	Policy and Claim Reserve Specialist
Randy Milquet	Financial Examiner EDP Specialist

Respectfully submitted,

Andrew Fell
Examiner-in-Charge